

Kellogg Company
Annual Report for 1977









1906

(Cover) Quality Control Belt Inspector Winnifred Olsen of Kellogg's Battle Creek, Michigan plant keeps a close eye on finished Corn Flakes as they travel rapidly from oven to packaging line.

Financial Highlights

(In millions except per share amounts)

	<u>1977</u>	<u>1976</u>	<u>Increase (Decrease)</u>
Net Sales	\$1,533.4	\$1,385.4	11%
Net earnings	\$ 138.2	\$ 130.4	6%
Per Common Share	\$ 1.81	\$ 1.71	6%
Dividends	\$ 85.9	\$ 75.4	14%
Per Common Share	\$ 1.125	\$ 1.00	13%
Additions to Properties	\$ 75.9	\$ 90.0	(16%)

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Scope of the Business

Kellogg Company manufactures and markets a wide variety of food products in the U.S. and abroad, including ready-to-eat cereals, toaster pastries, frozen waffles, soups, frozen pies, dessert mixes, tea, snack items and other convenience foods. The Company also engages in supporting activities such as grain milling and carton printing in a number of countries.

Products of the Company are sold through its own sales forces and through broker and distributor arrangements.

Distribution normally flows through jobber, independent and chain-store warehouses for resale to consumers in retail stores, restaurants, and institutional feeding establishments.

Each of the consumer food areas in which the Company is engaged is characterized by intense competition. This competition arises from manufacturers who offer the same type of products as Kellogg's, as well as from alternative foods of a wide variety.

Research and development activities designed to generate new and improved products, processing methods and packaging are conducted at the Battle Creek headquarters and at other plant locations around the world.



President W. E. LaMothe, left,
and Chairman J. E. Lonning

To Our Shareholders:

1977 was another year of record achievement and growth for Kellogg Company. Sales increased to \$1,533,400,000, and net earnings reached \$138,200,000, a 6% increase over earnings for the previous year. This marked the 33rd consecutive year of increased sales and 26th year of improved earnings. Reflecting satisfaction with our continued progress, the Directors voted to increase dividends 12.5% to \$1.125 per share.

These results are particularly gratifying due to the many challenges that confronted our business throughout the year. Price controls and government regulation in many markets continued to require an increasing share of management attention. Should worldwide inflation continue in line with current economic predictions, maintaining adequate profit margins in controlled markets will be one of the most serious problems facing us in the months ahead.

Foreign currency exchange rates continued to be unstable during 1977. However, currency exchange rate adjustments in our major foreign markets had an offsetting effect, resulting in little impact on earnings.

Trial of the Federal Trade Commission's so-called "shared monopoly" case against the Company and three other cereal producers continued during 1977. After a year and eight months of trial, the government completed presentation of its evidence in January, 1978.

Having heard the government's presentation, we remain convinced that the charges are without substance. We will continue to use our very best efforts to bring this case to a successful conclusion.

Kellogg ready-to-eat cereals continued to be one of the most popular breakfast choices with consumers around the world, based on the traditional but ever timely appeals of low cost per serving, nutritional value and convenience. Shifts in consumer preferences and increased demand in existing cereal categories provided a number of marketing opportunities, and we responded with several new cereal introductions. Kellogg non-cereal products also turned in strong performances.

While the unusually rapid volume growth experienced in the U.S. cereal market during the mid 1970's has returned to more historical levels, the excellent consumer appeal of these products and the comparatively high cost of other breakfast alternatives assure cereals of continued consumer demand and growth opportunity.

Capital expenditures during 1977 amounted to \$75,900,000 and we expect 1978 expenditures to approach \$100,000,000. Four major capital projects reached or neared completion, adding needed cereal production capacity in the United Kingdom, Germany, Mexico and the United States. Completion of these projects will enable us to meet growing demands for our key products, and will place us in a better position to take advantage of new product and marketing opportunities.

Three acquisitions were consummated during 1977, enabling the Company to enter several important new food categories in three countries. Acquired were: London Enterprises Pty. Limited, the largest frozen pizza manufacturer in Australia and also a producer of dessert pancakes and other frozen food products; the assets of Rhodes Frozen Foods Limited, a manufacturer of frozen bread products located in Skelmersdale, England; and Pure Packed Foods, Inc., an Arlington, Tennessee producer of

non-dairy creamers, toppings and desserts. These operations, while comparatively small, are building valuable experience and expertise within our organization and providing a solid base for future expansion and diversification.

The Company also purchased a cereal manufacturing operation in Barcelona, Spain, opening up a new market with excellent potential.

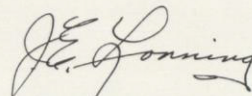
Several organizational changes were made to enhance our competitive position and profitability. The responsibility for Eggo brand frozen waffles was transferred from Fearn International Inc. to Mrs. Smith's Pie Company. Management responsibilities for European operations were consolidated. In Mexico we sold the snack foods division to concentrate on the rapidly expanding cereal operation. Also, we completed consolidation of the U.S. Salada marketing function with our Kellogg packaged goods operation and transferred the responsibility for the Canadian Mrs. Smith's operation to our Canadian Company.

Kellogg Company experienced more than its fair share of controversy during the year as a small but vocal group of activists made frequent use of various media to criticize the sugar content of ready-sweetened cereal products made by Kellogg and other companies in the cereal industry. We have allocated substantial human and financial resources over the years to develop a broad range of cereal products to appeal to consumers of all ages and provide balanced nutrition consistent with recommendations by government groups as well as independent and industry nutritionists. Based on a continuing review of reliable scientific data, we are firm in our conviction that each Kellogg breakfast cereal is a high quality, nutritious food worthy of complete consumer faith and confidence.

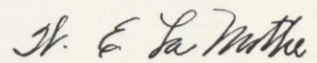
While we expect sugar content, advertising practices and other issues relating to the food industry to continue to command public attention during 1978, we are confident that the excellent reputation earned by our Company and its products over the past 70 years will be reflected in an ongoing consumer preference for foods carrying the Kellogg name.

Our faith in the future is based in large measure on the dedication of more than 20,000 Kellogg employees around the world to the pursuit of quality. Some of our employees directly responsible for assuring the excellence of our products are pictured in this report. It is to them and their co-workers at all levels that we dedicate our 1977 Annual Report, for it is their loyalty to corporate philosophies and pride in self-achievement that have made Kellogg and its subsidiary brand names synonymous with "quality" throughout the world.

On behalf of the Board of Directors and management we wish to offer sincere thanks to our shareholders, customers and suppliers for their continuing faith and support.



J. E. Lonning
Chairman of the Board



W. E. LaMothe
President



Operations Review

Marketing

Company sales reached all-time highs in 1977, reflecting solid growth in both domestic and foreign markets.

New product activity continued at a brisk pace in keeping with the Company's commitment to provide consumers with a broad range of quality food products. In the United States, *Cracklin' Bran*, *Corny-Snaps* and *Toasted Mini-Wheats* moved from successful test market areas into national distribution. Meanwhile, *Most*, a high-fiber multivitamin and iron supplement cereal, and *Danish Rings* toaster pastries were placed in test markets.

The *Le Goût* Division of Fearn International Inc. offered six new types of heat 'n serve entrées to food service customers: beef stew, beef stroganoff, Hungarian goulash, creole sauce with chicken, sweet and sour chicken with pineapple, and sliced beef in cream sauce. Several *Le Goût* soups are now available in nationally known fast food chains and family-style restaurants as the franchised restaurant business continues to offer excellent growth opportunities for the high quality *Le Goût* line.

Mrs. Smith's Pie Company, a leader in the frozen pie business with its traditional product line, has assumed marketing responsibility for the *Eggo* brand frozen food products that were previously marketed by Fearn. In addition, the marketing activities of Salada Foods Inc. are now carried on by the Kellogg marketing group.

The acquisition of Pure Packed Foods, Inc. added a new dimension to the Kellogg product line. Pure Packed Foods products include non-dairy creamers, toppings and desserts that are available to both retail and food service outlets under various private labels.

Eggo bran waffles were introduced to consumers throughout Canada. New additions to our European product line included *Bran Buds* in Germany, *Møllerens* spaghetti-bits in Denmark, and frozen waffles and *Variety* cereal assortment in Denmark and Sweden.

(Left) Paul Beha, mixer operator in the canning department of Fearn International Inc., Franklin Park, Illinois mixes the exact proportions of vegetables required to formulate a kettleful of *Le Goût* vegetable soup.





Other introductions around the world included *Frosted Rice* and instant refried beans in Guatemala; additional snack items in Brazil and Colombia; *Ready-Wheats* cereal, frozen dessert pancakes and savory (entrée) pancakes in Australia; *Happy Chef* spaghetti (a one pan dinner that needs only the addition of a liquid and meat) in Japan; and four flavors of *Lushus* diet jellies in South Africa.

The Company sold the snack food portion of its business in Mexico. While the ready-to-eat cereal market remains strong in that country, the snack food business was a small segment of our Mexican company that became economically unsound to continue.

Consumer interest in dietary fiber continued to be reflected in the increased sales of Kellogg's bran cereals in several markets throughout the world.

Concern expressed by consumers about many aspects of food and nutrition heightened during the year and prompted Kellogg Company to make greater use of its advertising to provide consumers with information about the nutritive value of Kellogg's cereals, overall Kellogg product quality and the value of a good breakfast.

Various print advertisements were used in leading publications to present this type of nutrition information. Three of these ads were winners of *Family Health Magazine's* Nutritional Advertising awards, making Kellogg Company an award winner for six straight years.

This was also the fifth consecutive year that the Company sponsored special "Good Breakfast" television messages. Aired weekly during child programming, these commercials attempt to educate youngsters about the importance of eating a good breakfast and do not include mention of specific Kellogg products.

Kellogg Company maintained its sponsorship of, and participation in, wholesome and entertaining television programs such as the Miss America Pageant, Captain Kangaroo, Little House on the Prairie, and "How the Grinch Stole Christmas".

Consumer Communications

Consumer communications were emphasized in areas other than advertising as consumer acti-

(Left) Martha Mull and Georganne McClure, right, inspect a run of frozen Eggo Waffles before they are packaged at the Eggo plant in Atlanta, Georgia.





vists continued to direct unfounded criticisms at the entire food industry.

A successful attempt to provide important nutritional information about ready-to-eat cereals took place in mid-November as the Company ran a full two-page advertisement in leading daily newspapers throughout the U.S. The ad, "A Statement from Kellogg Company on the Nutritional Value of Ready-Sweetened Cereals", was designed to present specific facts about this product category that have often been misconstrued.

Nutrition information was also provided to representatives of broadcast and print media. In addition, Kellogg nutritionists participated in various radio and television talk shows to discuss the nutritional value of Kellogg's cereals.

The Kellogg Nutrition Council (KNC), established in 1961, continues to make a significant contribution to nutrition education in countries throughout the world. In addition to its internationally distributed nutrition articles, the KNC's 16mm animated film "Journey Through Nutritionland" has been seen by millions of youngsters in classrooms, health centers, club groups and on educational television. Available internationally in eight different languages, the film is also being shown in the U.S. on a limited basis.

To best serve the interests of consumers and to accurately measure their wants and needs, the Company listens and responds to consumer comments and questions in the form of thousands of letters and phone calls each month. In addition, the Company's Battle Creek plant tour, which welcomed its five millionth visitor last summer, is used as a vehicle to collect consumer comments on issues of importance.

Having sponsored two "Stick Up For Breakfast" nutrition education programs in the early 1970's, Kellogg Company saw a real need for solid nutrition education in the schools. As a result of these programs, an entirely self-contained nutrition teaching module called "Energize at Sunrise" was developed specifically for elementary teachers. An "Energy 365" game is included in the module to encourage student interest and involvement. Thousands of units have been placed in distribu-

(Left) Charles D. MacKeen, Manager, Corporate Tea Purchasing for Kellogg Salada Canada Ltd, Montreal exercises refined tasting skills in selecting only the finest of high-grown teas for Salada blends.





tion throughout the country. In 1977, *Family Circle* Magazine awarded Kellogg Company a "Gold Leaf" award for producing and distributing outstanding nutrition education materials, especially "Energize at Sunrise". This marked the third time in the last five years that Company nutrition education materials have been recognized for their excellence by *Family Circle* magazine.

Manufacturing

Anticipated growth in demand for Kellogg Company products requires continuous expansion of production capacity and innovation of manufacturing techniques.

Significant capital projects during 1977 included:

- The new Lancaster, Pennsylvania cereal plant completed and operational in January, 1978.
- Purchase of Pure Packed Foods, Inc., an Arlington, Tennessee manufacturer of non-dairy milk substitute products.
- Start of a two million dollar expansion of the Battle Creek warehouse.
- First 24-oz. Corn Flakes Bag-in-Box packing line, a modern and efficient concept in packaging, installed at the Battle Creek plant.
- Major expansion and new pie production facility started at Mrs. Smith's McMinnville, Oregon operation.
- Additions to packaging and case goods handling systems to provide increased capacity and flexibility at the Omaha plant.
- Near completion of a major new cereal plant at Wrexham, Wales with production scheduled for mid-1978.
- Beginning construction of new carton and container plant seven miles from our Manchester, England cereal facility.
- Purchase of a frozen bread products business in Skelmersdale, England.
- Multi-million dollar expenditure to improve equipment and facilities, and expand corn flakes and bran flakes production capacities at the Canadian cereal operation.
- Acquisition of London Enterprises Pty. Limited,

(Left) Baker-working foreman David Morgan of Mrs. Smith's Pie Company, Pottstown, Pennsylvania carefully observes freshly baked lemon meringue pies as they move from the browning oven and are placed in racks to cool prior to freezing.



the largest frozen pizza manufacturer in Australia.

- Purchase of 80-acre site and beginning construction for new facility to produce pizzas, dessert pancakes and other frozen food products in Australia.
- Completion of major expansion at the Bremen, Germany cereal plant.
- Addition of a corn mill to the Denmark facility.
- Acquisition of a cereal company in Barcelona, Spain now called Kellogg-Figueras España, S.A.
- Increased corn flakes production capacity in Mexico.

Management Changes

Organization planning and development of capable management talents continued to demand attention in 1977. Evaluation of key personnel on a worldwide basis resulted in numerous promotions and other management changes including the advancement of the following Kellogg Company officers: R. L. Nichols to Executive Vice President, Marketing of Kellogg Company, a Director of Kellogg Company, and Chairman of the Board of Kellogg Sales Company; P. J. Kehoe to Senior Vice President, Manufacturing; G. E. Costley to Vice President, Assistant to the President.

In the Kellogg Sales Company, R. C. Fox was named Executive Vice President, General Marketing Manager.

R. C. Smith was named Chairman of the Board and D. L. Stevenson was designated President and Chief Executive Officer of Mrs. Smith's Pie Company.

G. D. Robinson was made Vice President, Kellogg International, Director of European Operations; C. E. Rechani was named General Manager of Alimentos Kellogg, S.A. (Venezuela); G. E. Gonzalez was appointed General Manager of Kellogg de Centro America S.A.; R. Buckland was elevated to Managing Director of Kellogg (Australia) Proprietary, Limited, while W. M. McGilvray was designated as Vice Chairman; and A. Brantley was appointed Managing Director of Kellogg-Figueras España, S.A.



Financial Review

Sales and Earnings

Sales and earnings in 1977 were the highest in our Company's history. Sales rose 11% to \$1,533.4 million, resulting in a 6% gain in earnings to \$138.2 million. Earnings for each common share were \$1.81 compared to \$1.71 for 1976.

Domestic sales of \$1,058.2 million, up 11%, accounted for \$111.7 million of earnings, an increase of 7% over 1976.

Foreign sales of \$475.2 million, also up 11%, accounted for \$26.5 million of earnings, a 1% improvement over 1976.

Currency exchange rates in our foreign markets remained unstable in 1977; however, the amount recorded as net exchange loss was not material.

Dividends and Common Stock

Cash dividends of \$85.9 million were paid to holders of common and preferred shares, representing 62% of net earnings for the year. The dividend on common stock of \$1.125 a share amounted to a 12½% increase over the amount paid in 1976.

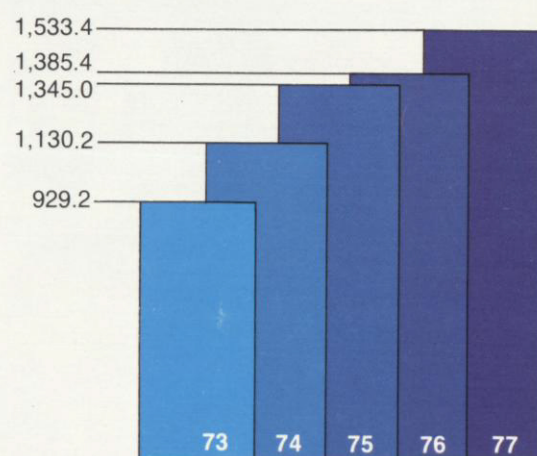
There were 76,389,877 shares of Kellogg common stock outstanding at year-end 1977. The quarterly price ranges as reported by the New York Stock Exchange, and dividends on the Company's common stock, which is listed and traded on the New York Stock Exchange, are shown below.

Dividend and Market Data

	1977			1976		
	High	Low	Dividend	High	Low	Dividend
1st Quarter	27⅞	23⅞	\$.275	24¼	20	\$.225
2nd Quarter	27¼	23¾	.275	25⅝	20⅞	.25
3rd Quarter	26¾	23⅞	.275	27⅞	24½	.25
4th Quarter	24¾	20¾	.30	28¼	25⅞	.275
			<u>\$1.125</u>			<u>\$1.00</u>

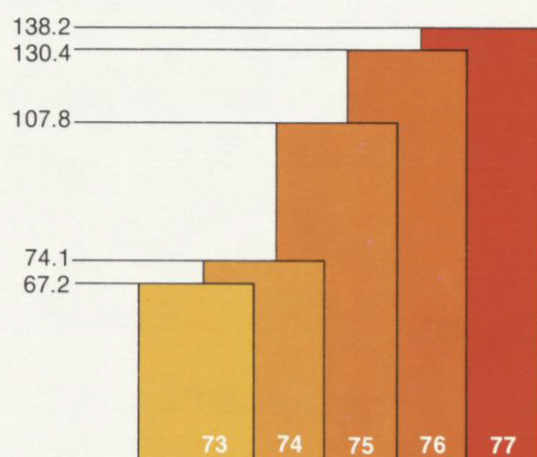
Net Sales

(Millions of Dollars)

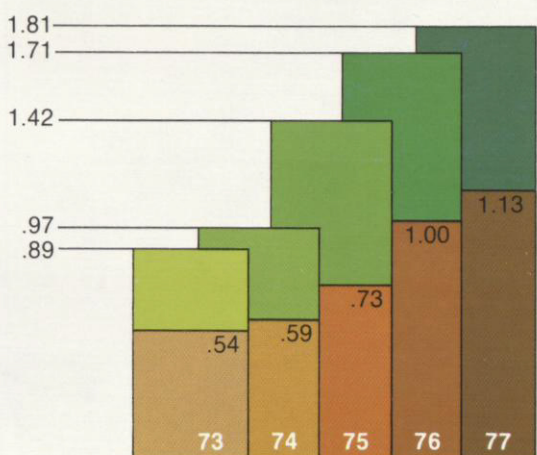


Net Earnings

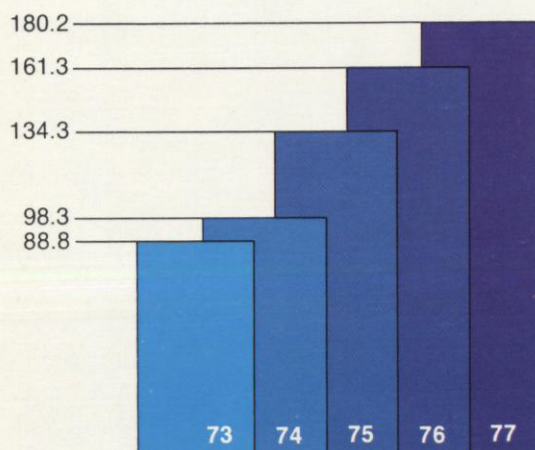
(Millions of Dollars)



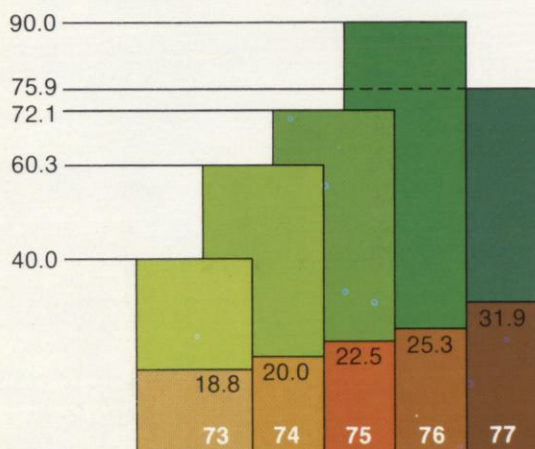
Net Earnings & Dividends Paid—Per Common Share (Dollars)



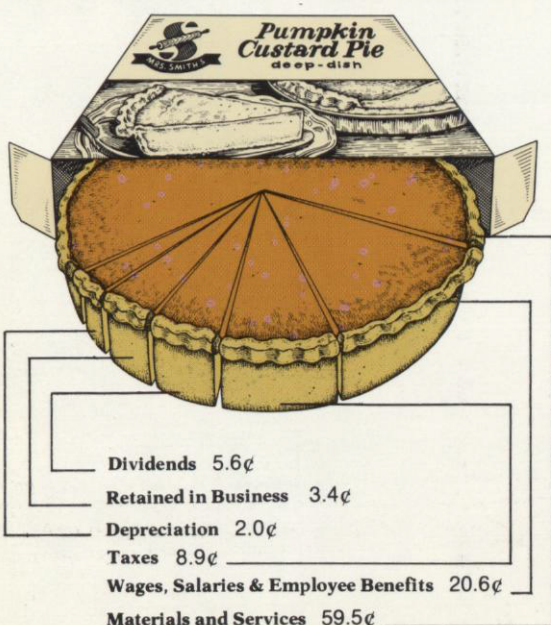
Working Capital Provided by Operations (Millions of Dollars)



Capital Additions and Depreciation (Millions of Dollars)



Distribution of Kellogg Sales Dollar 1977



Financial Position

The financial structure of the Company remained sound during the year. Cash and cash equivalents amount to \$81.2 million compared to \$117.7 million at year-end 1976. The ratio of current assets to current liabilities is 2.3 to 1 at year end and common shareholders' equity stands at a record high of \$542.3 million.

Working capital provided by operations amounting to \$180.2 million enabled the Company to finance capital expenditures and business acquisitions, increase the common stock dividend and still maintain a strong current ratio.

Capital Expenditures and Acquisitions

Modernization and expansion of the Company's manufacturing facilities throughout the world continued in 1977. Over the last four years capital expenditures have amounted to \$298.3 million. Expenditures in 1977 were \$75.9 million and are expected to be about \$100.0 million in 1978.

In 1977 more than half of the capital investment went toward expanding production capacity. Major expansion programs were conducted in the United States, Canada, Great Britain, Australia and West Germany. In the United States, construction of the Lancaster, Pennsylvania plant was completed. Expansion of the plant in Bremen, West Germany also was completed. The new plant in Wrexham, Wales is scheduled for completion in 1978.

In addition five businesses engaged in producing convenience food products were acquired in cash transactions amounting to \$14.1 million.

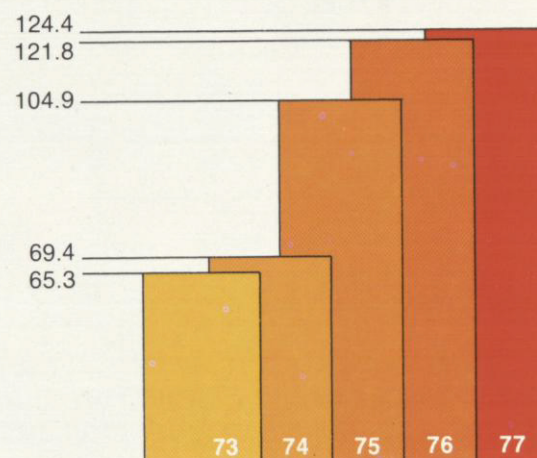
Taxes

The Company's provisions for income taxes for the past five years are summarized in the adjoining table. The 1977 amount is equal to 47.4% of pre-tax earnings for the year. Together with payroll taxes and other taxes not based on income, the total tax expense exceeded \$153.3 million.

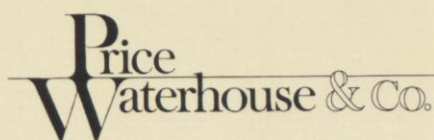
Income Taxes (Millions of Dollars)

	1977	1976	1975	1974	1973
United States					
Federal					
Current	\$ 91.3	\$ 86.9	\$ 77.8	\$49.5	\$47.2
Deferred	2.8	2.1	1.4	2.5	
State and Local					
Current	8.5	8.7	7.8	5.4	5.9
Deferred	.2	.1	.1	.1	
Foreign					
Current	13.3	17.0	10.9	9.6	9.7
Deferred	8.3	7.0	6.9	4.3	2.5
	<u>\$124.4</u>	<u>\$121.8</u>	<u>\$104.9</u>	<u>\$69.4</u>	<u>\$65.3</u>

Income Taxes (Millions of Dollars)



Report of Independent Accountants



To the Shareholders and Board of Directors of Kellogg Company

In our opinion, the accompanying consolidated balance sheets and the related consolidated statements of earnings, shareholders' equity and of changes in financial position present fairly the financial position of Kellogg Company and its subsidiaries at December 31, 1977 and December 31, 1976, and the results of their operations and the changes in their financial position for the years then ended, in conformity with generally accepted accounting principles consistently applied. Our examinations of these statements were made in accordance with generally accepted auditing standards and accordingly included such tests of the accounting records and such other auditing procedures as we considered necessary in the circumstances.

Battle Creek, Michigan
February 28, 1978

Price Waterhouse & Co.

Summary of Significant Accounting Policies

Consolidation

The consolidated financial statements include the accounts of Kellogg Company and its wholly-owned subsidiaries. Significant intercompany transactions are eliminated in consolidation.

Inventories

Inventories are valued at the lower of cost (principally average) or market.

Plant and Equipment

Fixed assets are stated at cost and depreciated over estimated useful lives using straight-line methods. The cost and accumulated depreciation of properties sold or retired are eliminated from the accounts and gains or losses on disposition are reflected in earnings. Expenditures for maintenance and repairs are charged against earnings. Renewals and improvements are capitalized.

Intangible Assets

Intangible assets represent the excess of unamortized cost over the fair market value of net assets of businesses acquired by purchase. An amount of \$19.0 million recorded prior to November 1, 1970 is not being amortized as it is considered to have continuing value over an indefinite period. The balance is being amortized over twenty-five to forty years.

Retirement Plans

The Company and its subsidiaries have various profit-sharing and pension plans to provide retirement benefits for employees. The Company's policy is to fund pension costs accrued. Unfunded prior service costs are being provided for generally over 30 years.

Earnings Per Common Share

Earnings per common share are determined by dividing net earnings (after deducting preferred stock dividends) by the monthly weighted average number of shares outstanding.

Income Taxes

Deferred income taxes are provided on revenues and expenses (principally depreciation) included in financial statements for periods other than the periods for which those revenues and expenses are reported for income tax purposes. Investment tax credits are used to reduce current income tax provisions.

It is the practice and the intention of the Company to reinvest indefinitely such earnings of foreign subsidiaries as may be required for the growth of businesses outside the United States. Accordingly, United States income taxes have not been provided on the unremitted current and prior years' earnings of these subsidiaries. The cumulative amount of undistributed foreign earnings at December 31, 1977 was approximately \$129.4 million.

Consolidated Earnings

(In millions)

Year ended December 31,	1977	1976
Net sales	\$1,533.4	\$1,385.4
Interest and other income, net	<u>7.6</u>	<u>8.3</u>
	1,541.0	1,393.7
Cost of goods sold	988.0	890.6
Selling, general and administrative expenses	281.2	241.9
Interest expense	<u>9.2</u>	<u>9.0</u>
	1,278.4	1,141.5
Earnings before income taxes	262.6	252.2
Income taxes	<u>124.4</u>	<u>121.8</u>
Net earnings	\$ 138.2	\$ 130.4
Earnings per common share	\$1.81	\$1.71

Shareholders' Equity

(In millions)

	Preferred Stock	Common Stock	Capital in Excess of Par Value	Retained Earnings
Balance, January 1, 1976	\$2.3	\$38.0	\$26.2	\$365.9
Net earnings in 1976				130.4
Dividends declared:				
Preferred stock—\$3.50 a share				(.1)
Common stock—\$1.00 a share				(75.0)
By acquired company prior to merger				(.3)
Stock options exercised		.1	2.0	
Other			.1	(.1)
Balance, December 31, 1976	<u>2.3</u>	<u>38.1</u>	<u>28.3</u>	<u>420.8</u>
Net earnings in 1977				138.2
Dividends declared:				
Preferred stock—\$3.50 a share				(.1)
Common stock—\$1.125 a share				(85.8)
Stock options exercised		.1	2.6	
Other			.1	
Balance, December 31, 1977	<u>\$2.3</u>	<u>\$38.2</u>	<u>\$31.0</u>	<u>\$473.1</u>

Consolidated Balance Sheet

(In millions)

At December 31,	<u>1977</u>	<u>1976</u>
CURRENT ASSETS		
Cash, including certificates of deposit of \$38.2 (\$78.9 in 1976)	\$ 48.8	\$ 87.7
Marketable securities, at cost which approximates market	32.4	30.0
Accounts receivable, less allowances of \$1.5 (\$1.6 in 1976)	108.7	84.1
Inventories:		
Raw materials and supplies	98.6	87.8
Finished goods and materials in process	72.8	61.1
Prepaid expenses	20.7	14.0
Total Current Assets	382.0	364.7
PLANT AND EQUIPMENT		
Land	17.3	13.3
Buildings	180.7	176.0
Machinery and equipment	407.6	329.7
Construction in progress	39.2	56.2
	<u>644.8</u>	<u>575.2</u>
Less accumulated depreciation	222.7	198.2
	<u>422.1</u>	<u>377.0</u>
INTANGIBLE ASSETS	29.4	19.1
OTHER ASSETS	5.5	4.7
Total Assets	<u>\$839.0</u>	<u>\$765.5</u>

At December 31,	<u>1977</u>	<u>1976</u>
CURRENT LIABILITIES		
Accounts payable	\$ 58.9	\$ 54.6
Loans payable, including current maturities of long-term debt	27.4	17.0
Income taxes	34.6	35.4
Accrued liabilities	44.7	45.1
Total Current Liabilities	165.6	152.1
LONG-TERM DEBT	80.3	85.9
OTHER LIABILITIES	8.0	6.5
DEFERRED INCOME TAXES	40.5	31.5
SHAREHOLDERS' EQUITY		
3½% Cumulative preferred stock, \$100 par value:		
Authorized and issued 70,513 shares less 47,686		
shares in treasury (74,263 less 51,169 in 1976)	2.3	2.3
Common stock, \$.50 par value:		
Authorized 80,000,000 shares; issued 76,389,877		
shares (76,219,064 in 1976)	38.2	38.1
Capital in excess of par value	31.0	28.3
Retained earnings	473.1	420.8
Total Shareholders' Equity	544.6	489.5
Total Liabilities and Shareholders' Equity	\$839.0	\$765.5

Changes in Consolidated Financial Position

(In millions)

Year ended December 31,	<u>1977</u>	<u>1976</u>
FINANCIAL RESOURCES WERE PROVIDED BY:		
Net earnings	\$138.2	\$130.4
Depreciation	31.9	25.3
Deferred income taxes and other changes	10.1	5.6
Working capital provided by operations	180.2	161.3
Issue of common stock	2.7	2.1
Sales of properties and other net changes	5.4	1.1
	<u>188.3</u>	<u>164.5</u>
FINANCIAL RESOURCES WERE USED FOR:		
Businesses purchased, net of working capital acquired	14.0	
Additions to properties, net of trade-ins	75.9	90.0
Cash dividends	85.9	75.4
Reduction in long-term debt	8.7	5.8
	<u>184.5</u>	<u>171.2</u>
Increase (Decrease) in Working Capital	<u>\$ 3.8</u>	<u>\$ (6.7)</u>
ANALYSIS OF INCREASE (DECREASE) IN WORKING CAPITAL:		
Cash	\$(38.9)	\$ 2.2
Marketable securities	2.4	(44.5)
Accounts receivable	24.6	6.1
Inventories	22.5	10.0
Prepaid expenses	6.7	4.3
Accounts payable	(4.3)	6.4
Loans payable	(10.4)	(.8)
Income taxes	.8	4.7
Accrued liabilities	.4	4.9
Increase (Decrease) in Working Capital	<u>\$ 3.8</u>	<u>\$ (6.7)</u>

Notes to Consolidated Financial Statements

(Dollars in millions)

Note 1. Operating Segments

The Company operates in a single industry, which is the manufacture and marketing of convenience food products throughout the world.

Operations by geographic area are shown in the table below. Transfers between geographic areas are not material. Corporate assets are principally cash and marketable securities. Changes in foreign currency exchange rates had no material effect on 1977 earnings. The pretax effect of foreign exchange losses amounting to \$5.8 mil-

lion in 1976 was reflected in consolidated earnings.

The consolidated financial data for 1976 include net assets of \$105.8 million, net sales of \$280.9 million and net earnings of \$13.8 million applicable to operations outside North America. These data are presented in conformance with accounting principles in effect in 1976, and therefore are not comparable to the data presented for 1977.

	<u>United States</u>	<u>Canada</u>	<u>Europe</u>	<u>Other Areas</u>	<u>Consolidated</u>
Year ended December 31, 1977:					
Net sales to					
unaffiliated customers	<u>\$1,058.2</u>	<u>\$130.1</u>	<u>\$220.2</u>	<u>\$124.9</u>	<u>\$1,533.4</u>
Net earnings	<u>\$ 111.7</u>	<u>\$ 8.7</u>	<u>\$ 12.9</u>	<u>\$ 4.9</u>	<u>\$ 138.2</u>
Identifiable assets					
at December 31, 1977	<u>\$ 434.1</u>	<u>\$ 95.1</u>	<u>\$139.0</u>	<u>\$ 86.0</u>	<u>\$ 754.2</u>
Corporate assets					<u>84.8</u>
Total assets					
at December 31, 1977					<u>\$ 839.0</u>

Note 2. Business Combinations

Five businesses in the convenience food products industry were acquired in cash transactions amounting to \$14.1 million in 1977. All have been accounted for as purchases and have been included in financial results from dates of acquisition. Results of operations prior to acquisition were not material.

The principal acquisitions were: Figueras Y. Cia., Barcelona, Spain, a producer of ready-to-eat cereals for the Spanish market; Pure Packed Foods, Inc., Arlington, Tennessee, a producer of dairy substitutes principally for the private label market in the United States; and a majority interest (with an option on the remaining interest) in London Enterprises Pty. Limited, Sydney, Australia, a producer of frozen pizza for the Australian market.

In 1976 Mrs. Smith's Pie Company, Pottstown, Pennsylvania, was acquired in a transaction accounted for as a pooling of interests, and financial data for all prior periods presented have been restated to include the accounts of Mrs. Smith's.

Note 3. Research and Development

Expenses for research and development approximating \$7.7 million in 1977 and \$7.5 million in 1976 were charged to earnings.

Note 4. Profit Sharing and Pension Expense

Profit sharing and pension expense amounted to approximately \$31.5 million in 1977 and \$30.9 million in 1976. Unfunded prior service costs at December 31, 1977 were estimated to be \$9.5 million, which included \$6.6 million of unfunded vested benefits.

Note 5. Leases

Rental expense and future minimum rental commitments under noncancelable leases, relating primarily to buildings and equipment, are not material.

Substantially all leases meeting the criteria for capitalization set forth in Financial Accounting Standard (FAS) No. 13 are reflected in the Balance Sheet at December 31, 1977. Prior years' financial statements are not restated because the effect of FAS No. 13 on financial position and net earnings for such periods is not material.

Note 6. Income Taxes

The provision for income taxes consists of:

	<u>1977</u>	<u>1976</u>
United States:		
Federal		
Current	\$ 91.3	\$ 86.9
Deferred	2.8	2.1
	<u>94.1</u>	<u>89.0</u>
State and Local		
Current	8.5	8.7
Deferred	.2	.1
	<u>8.7</u>	<u>8.8</u>
Foreign:		
Current	13.3	17.0
Deferred	8.3	7.0
	<u>21.6</u>	<u>24.0</u>
	<u>\$124.4</u>	<u>\$121.8</u>

Investment tax credits amounting to \$5.1 million in 1977 and \$3.7 million in 1976 were used to reduce current income tax provisions.

Note 7. Short-Term Debt

Short-term financing consists primarily of foreign bank loans. Information regarding such loans is:

	<u>1977</u>	<u>1976</u>
Amount at December 31 ..	\$23.0	\$12.9
Weighted average interest rate	7%	10%
Maximum amount outstanding during year	\$35.6	\$17.7
Average amount outstanding during year	\$22.0	\$14.1
Weighted average interest rate	8%	9%

Note 8. Long-Term Debt

Long-term debt consists of:

	<u>1977</u>	<u>1976</u>
8½% Notes, due 1985	\$75.0	\$75.0
Other	1.8	8.4
Foreign	4.4	6.6
Capitalized lease obligations	3.5	
	<u>84.7</u>	<u>90.0</u>
Less current maturities ...	4.4	4.1
	<u>\$80.3</u>	<u>\$85.9</u>

The Company may redeem the 8½% Notes after October 1, 1982 at principal amount plus accrued interest. The Indenture includes, among other things, limitations on the incurring of debt secured by mortgages on principal properties within the United States.

Note 9. Preferred Stock

The Company may redeem its outstanding preferred shares at a price of \$101 (\$100 after 1985). Each year the Company must offer to purchase 3,750 shares of preferred stock at a maximum price of \$100, or apply previously acquired shares (47,686 in treasury at December 31, 1977) against this requirement.

Note 10. Stock Options

Options to purchase common shares of the Company at market values on dates of grant have been granted to key employees under the Company's qualified stock option plans. The options, exercisable over four years beginning one year from date of grant, are as follows:

	Shares
Under option at December 31, 1976 (\$14.94 to \$19.25 a share)	425,678
Exercised at \$15.87 average a share ..	170,813
Canceled	16,485
Under option at December 31, 1977 (\$16.00 to \$19.25 a share)	<u>238,380</u>
Options exercisable at December 31, 1977	<u>228,500</u>

Note 11. Legal Matters

The Company is involved in various litigations incidental to the conduct of its business. Management does not consider that any such litigation, either individually or in the aggregate, can have, except as stated below, a material adverse effect on the Company.

In 1972 the Federal Trade Commission commenced a proceeding against Kellogg Company and three other cereal manufacturers charging that these companies have maintained a "highly concentrated, non-competitive market structure in the production and sale of (ready-to-eat) cereal" in violation of the Federal Trade Commission Act. The relief requested includes divestiture of assets, licensing of trademarks, prohibition of future acquisitions of competitors, and prohibition of shelf space activities. It is the position of Kellogg Company that it has not violated the Act and the Company, therefore, is contesting the charges vigorously.

In 1974 the U.S. Justice Department filed a suit against Mrs. Smith's Pie Company alleging that the 1973 acquisition of the Lloyd J. Harriss Pie Company and affiliates was a violation of the Clayton Anti-Trust Act. On April 28, 1977 the U.S. District Court entered an order requiring Mrs. Smith's to divest the acquired companies. Mrs. Smith's is taking action to comply with the order.

Note 12. Quarterly Data (Unaudited)

Consolidated data follow:

	Net Sales		Cost of Goods Sold	
	1977	1976	1977	1976
First	\$ 372.6	\$ 353.9	\$234.9	\$220.3
Second ...	386.6	349.4	245.7	223.0
Third	403.9	359.0	256.6	231.1
Fourth ...	370.3	323.1	250.8	216.2
	<u>\$1,533.4</u>	<u>\$1,385.4</u>	<u>\$988.0</u>	<u>\$890.6</u>
	Net Earnings		Earnings Per Common Share	
	1977	1976	1977	1976
First	\$ 41.4	\$ 38.6	\$.54	\$.51
Second ...	36.0	35.0	.47	.46
Third	38.3	35.8	.51	.47
Fourth ...	22.5	21.0	.29	.27
	<u>\$138.2</u>	<u>\$130.4</u>	<u>\$1.81</u>	<u>\$1.71</u>

Note 13. Asset Replacement Cost (Unaudited)

The Company has generally been able to compensate for the effect of inflation on overall production costs by increased operating efficiency and price adjustments.

Replacing items of plant and equipment with assets having equivalent productive capacity has usually required a substantially greater capital investment than was required to purchase the assets which are being replaced. The greater investment required is due primarily to inflation.

The Company's annual report on Form 10-K contains additional information regarding the estimated year-end 1977 replacement cost of inventories and plant and equipment, and the estimated effect of such cost on cost of sales and depreciation expense.

Although these estimates have been developed in good faith using accounting and statistical techniques, the Company makes no representation as to the usefulness of the replacement cost data and believes such data to be of questionable value.

Management's Analysis of the Summary of Operations

1977 Compared to 1976

Net sales increased \$148.0 million, with higher selling prices accounting for approximately \$113.0 million of the total. The balance of the increase represents sales of products of businesses acquired during the year, the sales of new products and increases in volume on existing products. Lower currency translation rates on foreign sales had an off-setting effect of approximately \$26.0 million.

An increase of \$97.4 million in cost of goods sold resulted principally from higher costs for raw material, labor, energy and other manufacturing costs. Raw material costs including those of businesses acquired and new products were up \$53.8 million, labor rose \$17.3 million and increases in freight, energy, employee benefits and fixed charges accounted for most of the balance. Maintenance and repairs were up \$6.0 million primarily because of increased costs of labor and repair parts. Depreciation increased \$5.2 million reflecting the continuing expansion and modernization of our plants.

Selling, general and administrative expenses rose \$39.3 million principally due to increased advertising and promotion expenses associated with new product introductions and increased costs of purchasing equivalent media advertising and promotion exposure.

1976 Compared to 1975

Earnings before income taxes increased \$39.5 million as a result of increased sales. There were increases in maintenance and repair costs of \$7.2 million due primarily to escalating costs of labor and repair parts. Also depreciation expense increased \$2.8 million, reflecting continued expansion and modernization of plants.

Income tax expense increased \$16.9 million and net earnings increased \$22.6 million generally corresponding to the gains recorded in earnings before taxes.

Five Year Financial Review

(Dollar amounts in millions, except per share figures)

	<u>1977</u>	<u>1976</u>	<u>1975</u>	<u>1974</u>	<u>1973</u>
SUMMARY OF OPERATIONS					
Net sales	\$1,533.4	\$1,385.4	\$1,345.0	\$1,130.2	\$929.2
% of increase	11%	3%	19%	22%	19%
Cost of goods sold	988.0	890.6	898.2	795.4	617.8
Interest expense	9.2	9.0	6.3	5.5	4.2
Earnings before income taxes	262.6	252.2	212.7	143.5	132.5
Income taxes	124.4	121.8	104.9	69.4	65.3
Net earnings	138.2	130.4	107.8	74.1	67.2
% of increase	6%	21%	45%	10%	8%
Per common share					
Net earnings	1.81	1.71	1.42	.97	.89
Cash dividends	1.13	1.00	.73	.59	.54
Average common shares (in thousands)	76,311	76,127	76,068	75,966	75,462
FINANCIAL POSITION					
Current assets	382.0	364.7	386.6	264.2	264.8
Current liabilities	165.6	152.1	167.3	127.0	129.9
Working capital	216.4	212.6	219.3	137.2	134.9
Current ratio	2.3:1	2.4:1	2.3:1	2.1:1	2.0:1
Plant and equipment (net)	422.1	377.0	316.9	269.5	231.7
Total assets	839.0	765.5	726.1	555.0	518.7
Long-term debt	80.3	85.9	91.7	20.5	20.9
Common shareholders' equity	542.3	487.2	430.1	375.6	340.3
OTHER STATISTICS					
Capital expenditures	75.9	90.0	72.1	60.3	40.0
Depreciation	31.9	25.3	22.5	20.0	18.8
Cash dividends					
On 3½% preferred stock	.1	.1	.1	.1	.1
On common stock	85.8	75.3	53.9	43.8	39.8
Increase in retained earnings	52.3	54.9	53.8	30.3	9.1
Number of shareholders	20,351	20,054	19,940	19,889	19,804
Average number of employees	20,405	19,720	19,487	19,139	18,288

Board of Directors

P. H. Smucker^{(1), (3)}
Chairman and President,
The J. M. Smucker Co.

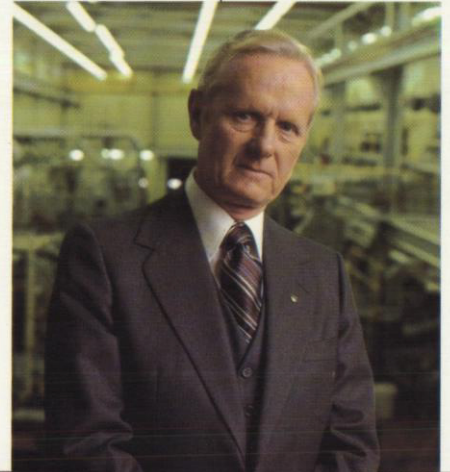
R. L. Nichols
Executive Vice President,
Marketing

George Champion^{(1), (2)}
Chairman of the Board, Economic
Development Council of
New York City, Inc.

J. E. Lonning^{(1), (3)}
Chairman of the Board
and Chief Executive Officer

John Sugden
Senior Vice President,
Corporate Development

Dolores Wharton⁽¹⁾
Author and Lecturer



W. E. LaMothe⁽¹⁾
President and
Chief Operating Officer



L. C. Roll^{(1), (3)}
Vice Chairman of the Board,
Chairman of the Executive
Committee, and Consultant

K. V. Zwiener^{(1), (2)}
Former Chairman, Harris Trust
and Savings Bank

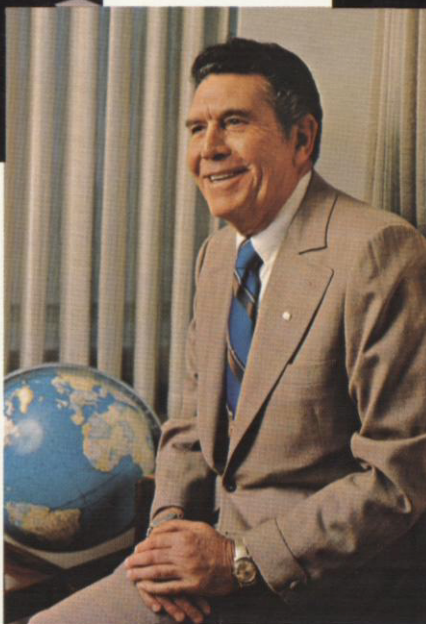
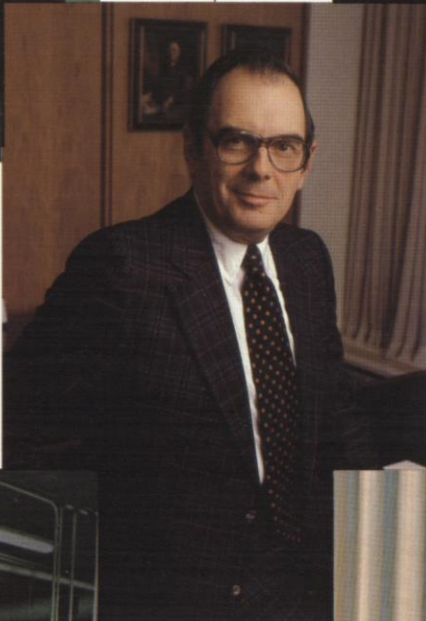
W. T. Redmond
Executive Vice President,
Administration

R. G. Mawby⁽¹⁾
President, W. K. Kellogg Foundation

J. O. Snook^{(1), (2)}
Member, Concannon, Dillon,
Snook & Morton, Attorneys

Norman Bristol
Executive Vice President,
General Counsel, and Secretary

A. H. Aymond^{(1), (3)}
Chairman and
Chief Executive Officer,
Consumers Power Company



D. M. Harrison
Executive Vice President,
Production

C. A. Tornabene
Vice Chairman, President
Kellogg International

(1) Member Executive Committee
(2) Member Audit Committee
(3) Member Compensation Committee

Worldwide Organization

OFFICERS

J. E. Lonning
Chairman of the Board and
Chief Executive Officer

W. E. LaMothe
President and Chief Operating Officer

C. A. Tornabene
Vice Chairman of the Board and
President, Kellogg International

Norman Bristol
Executive Vice President, General Counsel
and Secretary

D. M. Harrison
Executive Vice President, Production

R. L. Nichols
Executive Vice President, Marketing

W. T. Redmond
Executive Vice President, Administration

J. H. Hopper
Senior Vice President, Scientific Affairs

P. J. Kehoe
Senior Vice President, Manufacturing

V. E. Kronemeyer
Senior Vice President, Purchasing

John Sugden
Senior Vice President,
Corporate Development

F. C. Buhler
Vice President, Research

R. L. Burrows
Vice President, Purchasing

G. E. Costley
Vice President, Assistant to the President

J. D. Forbes
Vice President, Technical Development

R. C. Fox
Vice President, Domestic Sales Manager

C. J. McNaughton
Vice President, Employee Relations

J. R. O'Brien
Vice President, Corporate Counsel and
Assistant Secretary

L. R. Somers
Vice President, Finance

T. R. Sykes
Vice President, Traffic

D. R. Wilson
Vice President, Engineering

J. C. Melangton
Treasurer and Assistant Secretary

J. L. Nequist
Controller

UNITED STATES

KELLOGG SALES COMPANY

Battle Creek, Michigan

R. L. Nichols
Chairman & President

R. C. Fox
Executive Vice President

J. R. Aubuchon
Executive Vice President

R. D. Bateman
Vice President

R. C. Bland
Vice President

F. J. Cleveland
Vice President

R. L. Myers
Vice President

E. M. Renger
Vice President

W. H. Swain
Vice President

R. W. Taylor
Vice President

EASTERN REGION

F. J. Eller
Vice President, Regional Manager

Division Sales Managers:

B. C. Irvin
Boston, Mass.

R. D. Smith
Columbia, Md.

H. J. Cudia
New York, N.Y.

D. A. Baragar
Philadelphia, Pa.

S. J. Guter
Pittsburgh, Pa.

SOUTHERN REGION

A. J. Simpson
Vice President, Regional Manager

Division Sales Managers:

T. J. Helldorfer
Atlanta, Ga.

T. E. Tinsley
Dallas, Texas

L. D. Hamrick
Jacksonville, Fla.

R. L. Barbee
Memphis, Tenn.

CENTRAL REGION

A. E. Howells
Vice President, Regional Manager

Division Sales Managers:

R. B. Chapin
Chicago, Ill.

T. W. Holycross
Cincinnati, Ohio

W. T. Lambert
Detroit, Mich.

L. R. Lentz
Minneapolis, Minn.

R. L. Skinner
St. Louis, Mo.

WESTERN REGION

E. C. Guinn
Vice President, Regional Manager

Division Sales Managers:

B. G. Baker
Los Angeles, Calif.

F. B. Drass
San Francisco, Calif.

E. W. Scribner
Seattle, Wash.

MANUFACTURING LOCATIONS

Battle Creek, Michigan
C. C. Burry
General Plant Manager

San Leandro, California
I. M. Kezich
General Plant Manager

Omaha, Nebraska
P. A. Humiston
General Plant Manager

Memphis, Tennessee
W. A. Porter
General Plant Manager

Lancaster, Pennsylvania
C. P. Taylor
General Plant Manager

FEARN INTERNATIONAL INC.

D. E. Thompson
President

Plant Locations:

Franklin Park, Illinois
Los Angeles, California

SALADA FOODS INC.

R. C. Fox
President

Plant Locations:

Little Falls, New York
Plant City, Florida

MRS. SMITH'S PIE COMPANY

R. C. Smith
Chairman

D. L. Stevenson
President

Plant Locations:

Pottstown, Pennsylvania
Morgantown, Pennsylvania
Philadelphia, Pennsylvania
York, Pennsylvania
Silver Spring, Maryland
Saugatuck, Michigan
Shelby, Michigan
Portsmouth, Virginia
McMinnville, Oregon
San Jose, California
Atlanta, Georgia

PURE PACKED FOODS, INC.

J. D. Wells
President

Plant Location:

Arlington, Tennessee

CANADA

KELLOGG SALADA CANADA LTD

A. G. Langbo
President

Plant Locations:

London, Ontario
Toronto, Ontario
Alliston, Ontario
Montreal, Quebec
Simcoe, Ontario

KELLOGG INTERNATIONAL

C. A. Tornabene, President

H. L. Green, Vice President,
Director Marketing Services

W. A. Camstra, Vice President,
International Development

B. D. White, Vice President,
International Finance

EUROPE

G. D. Robinson, Vice President,
Director of Operations

**Kellogg Company of
Great Britain, Limited**
Askeys Limited
Favorite Food Products Limited

G. D. Robinson
Chairman and Managing Director

Kellogg's Food Products S.A.
(Belgium)
Kellogg's Food Products S.A.N.V.
(Dutch Branch)

E. Nurenberg
General Manager

Nordisk Kellogg's A/S (Denmark)

M. Hansen
Managing Director

Kellogg's Produits Alimentaires, S.A.
(France)

J. Galle
General Manager

Kellogg (Deutschland) GmbH

H. Schroder
Managing Director

Kellogg-Figueras España, S.A.

A. Brantley
Managing Director

AFRO-AUSTRALASIA

W. C. Nicolson, Vice President,
Director of Operations

**Kellogg (Australia) Proprietary,
Limited**

W. M. McGilvray
Vice Chairman

R. Buckland
Managing Director

London Enterprises Pty. Limited*

Kellogg (Japan) K.K.

J. T. Shikami
President

**Kellogg Company of South Africa
(Proprietary) Limited**

D. A. Wood
Managing Director

LATIN AMERICA

E. A. Jimenez, Vice President,
Director of Operations

**Kellogg Company Argentina,
S.A.C.I.F.**

J. C. Capello
General Manager

**Produtos Alimenticios Kellogg's
Limitada (Brazil)**

C. S. Miranda
General Manager

Kellogg de Colombia, S.A.

O. J. Aguera
General Manager

Kellogg de Centro America, S.A.
(Guatemala)

G. E. Gonzalez
General Manager

Kellogg de Mexico, S.A. de C.V.

L. A. Williams
General Manager

Alimentos Kellogg, S.A. (Venezuela)

C. E. Rechani
General Manager

CARIBBEAN

Salada Foods Jamaica Limited**

K. C. Falconer
General Manager

Salada Belize Limited
Belize Feed Limited***

D. F. Jenkins
General Manager

Caribbean Foods Limited****

L. O. Ramson
Chairman and Managing Director

*67% Ownership

**48% Ownership

***78% Ownership

****75% Ownership

Manufacturing Locations:

Buenos Aires, Argentina
Auburn, Australia
Sydney, Australia
Sao Paulo, Brazil
Stann Creek, Belize, C.A.
Bogota, Colombia
Svendborg, Denmark
Aylesbury, England
Manchester, England
Skelmersdale, England
Helsinki, Finland
Bremen, Germany
Guatemala City, Guatemala
Dublin, Ireland
Kingston, Jamaica
Takasaki, Japan
Queretaro, Mexico
Otahuhu, New Zealand
Springs, South Africa
Barcelona, Spain
Maracay, Venezuela

GENERAL INFORMATION

Independent Accountants:
Price Waterhouse & Co.

**Transfer Agents
and Registrars:**
Harris Trust and Savings Bank,
Chicago, Illinois

The Chase Manhattan Bank, N.A.
New York, N.Y.

Common Stock Listed
New York Stock Exchange
Ticker Symbol-K

Kellogg's

KELLOGG COMPANY, BATTLE CREEK, MICHIGAN 49016